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CHINESE COMMUNIST COMMERCIAL POLICY

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SUMMARY

Up to the present time, Chinese Communist economic policy has not been directly concerned with the problems of foreign trade. Power has been centralized in the countryside, and economic objectives, related as they were to the civil war, have been defined largely in terms of local self-sufficiency. Whatever inferences past economic practices in general can provide for an estimate of the future commercial policy of the Chinese Communist Party relate primarily to the principles on which such practices were based. In this context, the party's past performance indicates that doctrine has not set sharply restrictive limits to the flexibility of economic policy. Although the ultimate objective of a Communist state has never been abandoned, immediate practice with regard to such matters as land tenure, taxation, and the role of private enterprise in commerce and industry appears to have been determined more on the basis of expediency than by strict adherence to preconceived doctrines.

In the event of Communist accession to power over a consolidated China, commercial policy would be of immediate concern to Communist authorities. With regard to the mechanics of trade, it would appear that a Communist government would tend increasingly toward state trading activities. This conclusion is indicated both by the past economic practices of the Chinese Communist Party and by the government's future requirements. It tends to be reinforced, moreover, by consideration of the policies pursued by Communist

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governments in other areas and by the realization of the magnitude of the state trading base a Communist government would inherit from the present National Government.

The question of where foreign trade is to be conducted would raise for a Communist government in China certain critical problems because of the conflict between that government's political inclinations and its economic requirements. It is clear that the cessation of hostilities and the revival of internal trade would greatly improve China's balance of payments position over that of the National Government during the postwar period. Under certain favorable assumptions -- e.g., that effective controls will be placed over foreign trade, that the fiscal structure will be improved, and, perhaps most important, that the government will be willing and able to trade in markets where its economic advantages are maximized -- it is estimated that over a five-year period a Communist government could finance its essential current import requirements in addition to a considerable portion of its requirements for high-priority reconstruction.

This possibility can be largely discounted if trade is forced into channels dictated by political factors. Expansion in China's trade with the USSR, for example, occurring at the expense of trade with the West, would mean a serious reduction in China's receipts from exports and at the same time reduce its access to areas where

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its import requirements could be most effectively met. It is possible, of course, that for political reasons the USSR may choose to subsidize such expanded trade with China at the expense of its domestic economy. If, on the other hand, the USSR adopts a policy of economic exploitation in China, similar to those it has pursued in some of its Eastern European satellites and one that its position in Manchuria could effectively support, the prospect for an early reconstruction of the Chinese economy would be appreciably dimmed.

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CHINESE COMMUNIST COMMERCIAL POLICY

INTRODUCTION

The international trade policies adopted by the Chinese Communist Party after its accession to governmental authority over all or most of China will bear importantly upon the role of China in world affairs. At issue in the first instance will be the attitude of China toward the postwar movement for a world free from unduly restrictive trade practices. Beyond this, there will arise problems relating to foreign enterprise in China, to the Chinese external debt, to China's economic (and, inescapably, political) relations with its neighbors, and to Chinese domestic economic and political policies.

In the present paper an attempt is made to point out the probabilities with regard to this aspect of Communist over-all policy. Two more or less independent approaches are used for the analysis. The first consists of an examination of the Chinese Communist Party's economic policies in the past for clues as to the nature of future policies. The other is an estimate of the economic problems that will face the Communists after taking over power and a projection of the kinds of policies that would seem most probable in the light of these problems.

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Chapter I, "The Development of Chinese Communist Economic Policy," is therefore a summary of the past record of the Communists in economic policy. It is offered both as a partial index to the future and as a comprehensive review of an important aspect of the development of the Communist Party in China. It is not, however, necessary to the main argument of the paper.

Chapter II, "The Economic Determinants of Future Commercial Policy," treats directly the question of future Communist actions. The argument here is largely independent of Chapter I, and the section may be read, if desired, without reference to the earlier part of the text.

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I. THE DEVELOPMENT OF CHINESE COMMUNIST ECONOMIC POLICY

Chinese Communist economic policy has been characterized by a willingness to adjust doctrine to reality, within the fairly broad limits set by ultimate and fixed objectives. Communist statements on economic policy have, of course, stressed most of the formal aspects of Communist ideology, but much of this doctrine has represented ideological baggage excess to the agrarian economy in which control was exercised. In the relatively narrow sphere where doctrine was germane to the given situation, the Chinese Communist Party (CCP) has not hesitated to reexamine ideology and adjust economic policy to conform to immediate requirements.

A. The First Civil War, 1927-36

After splitting with the Kuomintang in 1927, the Chinese Communist Party made several abortive attempts to gain political control in China through the support of urban workers. Revolutionary policy called for confiscating the property of the wealthy and nationalizing both land and large enterprises, and included various provisions designed to improve industrial working conditions and living standards and to insure worker control over industry. The ultimate failure of this approach and the destruction of Communist support in the cities shifted the party's emphasis to the rural areas, where it subsequently emerged as a political force in scattered interior sections of southern and central China.

These scattered pockets of Communist control were organized in 1931 into a Chinese Soviet Republic, with its capital in Kiangsi Province. The constitution and the land law of the Republic reflected a moderating of that part of the party's policy heritage that was in conflict with the requirements of the new situation. The general approach was still phrased in terms of radical class warfare and included nationalization of the land as an ultimate goal. But economic tactics in the key sector of agrarian policy aimed at confiscating and redistributing only the holdings of wealthy landlords and "feudal" interests, leaving intact both the property of middle peasants and the institution of private property on the land. As policy evolved, the private sector was recognized as one part of the economy -- for the time being the predominant part -- operating in conjunction with the state and cooperative sectors.

The elaborate provisions regarding working conditions and labor control in industry were reaffirmed, but had only limited reference to the agrarian economy in which the Chinese Communist Party operated. Fiscal and tax policy, however, were of somewhat greater relevance. Government revenues were to be derived largely from agricultural and commercial taxes collected in kind and "imposed on the exploiters." Although private trade was permitted and in some respects encouraged, the party took steps to control both the

quantity and composition of goods moving through the Kuomintang blockade. In January 1934, Chairman Mao Tse-tung was able to report "initial success" in the operation of a foreign trade bureau, the objective of which was to organize foreign trade so as to maximize its contribution to the requirements of the base areas.

B. Economic Policy During the War with Japan

1. Changes in Short-Term Objectives. The retreat of the Chinese Communist Party to its base area in northwest China in 1935 and its subsequent coalition with the Kuomintang in 1937 against the Japanese ushered in an abrupt shift in the party's short-term objectives. Primary emphasis was transferred from increasing the relative power of peasants and workers in the class struggle to expanding the forces opposing Japanese aggression. The rationalization of this change to conform with the ultimate objective of a socialist state was later expressed in Mao Tse-tung's New Democracy. In essence, Mao argued that the ultimate assumption of control in "feudal" China by the proletarian class must be preceded by a revolution culminating in a "democratic" state controlled by an alliance of bourgeois and proletarian elements and aiming at economic development through the use of both state and private capital.

The precarious nature of the Communist Party's initial position in northwest China suggests that this change in policy was motivated as much by expediency as by ideology. In contrast to

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conditions in South China, farming in the north was subject more to the vicissitudes of climate than to variations in the pressure of "feudal" exploiters. The incidence of farm tenancy was lower than in South China, villages were smaller in size, and the peasantry was more isolated from commercial channels and urban centers. This complex of environmental factors resulted in a conservative peasantry that in general was less susceptible to the attractions of a radical agrarian policy. In consequence, the Communist bid for popular support in the north required a change in economic tactics. Even before the conciliation with the Kuomintang, Chinese Communist land policy was moderated to conform with these new requirements. This trend was subsequently extended and, coupled with the program of resistance to the Japanese, it immediately enlarged the base of Chinese Communist Party support.

2. Changes in Economic Tactics

a. Land policy. Abandonment of the policy of radical class warfare in favor of moderate reform was reflected in the land measures initiated in 1937 and subsequently developed during the course of the war. Instead of forcible land confiscation, the new agrarian regulations called for a reduction of 25 percent in rent, with the proviso that the total rent could not exceed 37½ percent of total output. Tenure rights on the land were strengthened in favor of the tenant, and interest rates were

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limited to a maximum of 10 percent per year. These measures were enforced in varying degree, depending on local conditions, but their effect was to increase popular support for the Communist Party at the expense of the rentier class. The conflicting Communist objective of maximizing the war effort against the Japanese through a united class front tended to limit this trend.

b. Economic warfare. Communist control in North China was limited to interior areas cut off from normal communications by the Japanese occupation of the major cities and by the Kuomintang blockade. Under these conditions, the survival of the Chinese Communist Party as an effective operating force in the war depended on the development of a self-sufficient economy geared to the support of the army. Consistent with this requirement in terms of appropriate economic policy was the additional aim of minimizing Japanese exploitation of the area.

The drive toward self-sufficiency and the effective mobilization of resources for war was reflected largely in production and tax policy. Agricultural output for local consumption was increased by a directed shift in agriculture from the production of formerly "exportable" cash crops to grain crops; the partial use of the army as an agricultural labor force on submarginal land; and the cooperative organization of agricultural labor on a part-time

basis to make physical improvements on the land. To minimize the need for "imported" manufactured products, rural handicraft output was increased, and small-scale private industry was encouraged through the maintenance of profit incentives.

The fiscal policy of the Chinese Communist Party operated within the framework of a grain economy in which currency played a subsidiary role. Taxes were collected largely in grain and stored locally for government disbursement. In general, the government taxed both capital and income on a progressive basis, but there is some indication that the tax base was enlarged during the latter stages of the war. By this time, however, the position of the Communist Party was sufficiently secure to withstand the political pressure of an increase in the tax burden on the lower income groups.

Restrictions on the flow of commodities moving through the blockade were extended as the war progressed, and gradually effective control was established over the whole economy of the border region. At first measures to control commerce were limited to regulations that loosely defined the classes of commodities in which "foreign" trade was permitted and to the collection of taxes on such commodities passing through border control points. Since private trade within the base areas remained unrestricted, the Communist authorities were soon faced with a serious smuggling problem. The

countermeasures eventually included a large degree of control over all marketed output, agricultural as well as industrial. Grain was purchased by government agencies and distributed to the villages through the cooperatives. Firms desiring to move commodities between districts within the base areas had to be registered with trade control bureaus and were required to obtain specific authorization for each shipment. In the case of commodities moving outside the base areas, security had to be deposited before shipment to insure the return movement of appropriate kinds and quantities of imports. Although trade was handled largely through private channels, the effect of these regulations was to give the authorities power over both the terms of the trade and its composition.

C. Postwar Developments

1. Policy Trends

a. Land policy. The Chinese Communist Party entered the postwar period with its policy of economic moderation presumably reaffirmed. Mao Tse-tung had announced in April 1945 that if "no unusual difficulty" arose the party intended to let its program of rent and interest reductions stand and to continue to foster the growth of a cooperative and private capitalist economy as a necessary process involved in the Marxist law of social development. He said,

in addition, that owing to China's huge capital requirements for developmental purposes, foreign investments were needed and desired, provided that such investments were made and managed in "subservience" to China's laws.

Subsequent developments, however, apparently called for an early scrapping of the land policy. In the struggle for postwar control over the areas abandoned by the Japanese, land confiscation and redistribution proved too potent a political weapon for the Communists to renounce. A system of "settling accounts" in which peasant grievances against landlords were aired and restitution payments assessed in open meetings seems to have been widely applied shortly after the end of the war. This, in turn, soon gave way to expropriation of excess landholdings for redistribution to the landless or to those deemed to have insufficient land. Since administration of these measures was left largely in the hands of local peasant movements and since many of the fundamental concepts embodied in the program remained ill-defined, results varied widely among the Communist-controlled areas. Although land confiscation and redistribution were formalized in the agrarian law of October 1947, subsequent pronouncements by party leaders reflected the twin objectives of reassuming controls relinquished to the peasant movements and changing tactics to conform with political events.

The Nationalist Government's defeat in Shantung in the spring of 1947 and the successful Communist offensive in Manchuria during the summer of 1947 turned the military tide decisively in favor of the Communists. The prospects pointed to the capture of large cities (Shih-chia-chuang fell to the Communists in November 1947) and to the possibility of consolidating control over large areas in Manchuria and North China.

In the context of these prospects, a program of agricultural extremism, to some extent outside the control of the central authorities, could be a political and economic liability. A series of policy statements dating from the latter part of 1947 and extending well into 1948 attest to the concern of party leaders with policy adjustments. In December 1947 Mao announced that at the then current stage of the revolution the objective was to eliminate "feudalism and monopoly capitalism," but not capitalism in general or the petty and middle bourgeoisie in particular.¹ Confiscation was appropriate to the holdings of only approximately 8 percent of the families, and in executing the program care must be taken not to misclassify "middle" peasants in the "rich" peasant category.

1. Mao Tse-tung's report, "Present Situation and Our Tasks," as quoted in FBIS, Daily Report, January 5, 1948, pp. 1-11, RESTRICTED.

Again, in April 1948, Mao warned against repeating past errors of indiscriminately following the wishes of the masses and of failing to tailor principles to the differing conditions existing in "the old, semi-old, and new liberated areas." Absolute equalitarianism, for example, "is a kind of agrarian socialist thought...reactionary, backward, and retrograde in nature."¹ This general theme was echoed in the statements of other party functionaries during the same period. "A leftist tendency to encroach on the interests of the middle peasants" must be avoided or too large a group will be alienated against the revolution.² With increased consolidation of political control (as in the merging of two border areas into the North China Liberated Areas in the second quarter of 1948), party pronouncements called for a shift in emphasis from agrarian reform to a policy tending to unify the various economic strata so as to speed economic restoration and increase output.³

b. Policy toward industry and commerce. Announced policy toward industry and commerce during the same period reflected an even

1. FBIB, Daily Report, May 11, 12, and 13, 1948, RESTRICTED. Subsequently, in the newly established Central Plains Liberated Area, the initial agrarian reform program was abandoned for one of rent and interest reductions because the conditions for such a program had "not yet matured" and the peasants had not yet been "prepared ideologically and organizationally." (FBIB, Daily Report, September 3, 1948, p. CCC-3, RESTRICTED).
2. Jen Pi-shih, member of the Chinese Communist Party's Central Committee, in a speech on Chinese agrarian reform delivered on January 12, 1948 and published in FBIB, Daily Report, April 16, 17, 19, and 20, 1948, RESTRICTED.
3. Editorial entitled, "Present Tasks of the North China Liberated Area," published in the Chinese Communist Party's People's Daily of June 15, 1948, as quoted in FBIB, Daily Report, June 22, 1948, p. PPP-7-13, RESTRICTED.

greater effort to conciliate the private sector in the interests of political order and economic recovery. "Bureaucratic capital" was to be taken over by the state just as "feudal land-holdings" were to be confiscated, but "adventuristic policies must not be adopted toward commerce and industry" in general.¹ Thus, Mao warned against past errors in confiscating industrial properties owned by rich landlords and peasants.² If landed proprietors transferred their capital from agriculture to industry, their interests should be protected and encouraged. In general there should be explicit recognition of the fact that private industry, as an adjunct to public and cooperative industry, could contribute an important share to the development of the Chinese economy at this state of the revolution, and tax, labor, and trade policy should be geared to this principle.

Tax policy had to be equitable, non-confiscatory, and designed so as not to cripple output. At the same time, however, it was to be instrumental in allocating economic resources toward public ends. In general, essential industries should be taxed less than non-essential industries, and industry as a whole taxed less than commerce. This latter aspect of tax policy reflected the viewpoint of traditional doctrine; commerce in itself does not create value, and even

1. Jen Pi-shih, op. cit.

2. FBIS, Daily Report, May 11, 1948, p. PPP-9-14, RESTRICTED.

"legitimate commerce merely performs the function of circulating commodities. However, it is a kind of economic activity indispensable for the development of production in certain societies."¹

Recent labor policy reflects a similar willingness to subjugate traditional doctrine to immediate needs. There is the same lip service to improved working conditions as was given throughout the development of the Chinese Communist Party's economic policy, when the agrarian nature of the areas controlled made the policy of limited significance. But, with control over important cities an immediate prospect, labor is reminded that, as the proprietor of government enterprise, it should regard its interests from a long-range point of view² and, as the leading class in the state, it "must shoulder the responsibility for developing industry."³ Even in privately owned plants, exploitation is limited by the fact that the workers "enjoy the status of political leadership."⁴ The conclusion, therefore, is that wages must not be excessive and must be reduced if they impair output. Furthermore, differential wages should be used both to encourage output and to gain the support of technicians. Piecework wages and incentive systems may not be

1. "The Labor Policy and Tax Policy for Developing Industry," by Chen Po-ta, member of the Chinese Communist Party's Central Committee, as quoted in FBIB, Daily Report, April 27-29, 1948, RESTRICTED.
2. FBIB, Daily Report, February 10, 1948, p. CCC-1-2, RESTRICTED.
3. Report to the Sixth All-China Labor Congress at Harbin as quoted in FBIB, Daily Report, August 10, 1948, p. CCC-1-3, RESTRICTED.
4. Ibid.

appropriate to a Communist economy, but this is the stage of "liberal capitalism." To attempt to jump this gap would be "to violate the laws of social development."¹

A recent statement reaffirming the principle of free trade within the liberated areas includes the provision that "each locality must charge only the set tax on commodities." Goods exported outside the area are to be subjected to a uniform duty collected only at one place, and, "with the exception of contraband goods, all commodities should be allowed to enter the liberated areas."²

Perhaps the most straightforward and strongest endorsement of the new policy protecting private enterprise is contained in a liberated area directive issued in April 1948.³ All industrial and commercial enterprises, including those owned by landlords and rich farmers, are guaranteed protection, and such property as was confiscated in the past is to be returned to former owners if distribution has not been made; the general land law cancelling land debts is held not to apply to commercial and industrial debts; and state enterprises harmful to the development of private enterprise are to cease operations. Private industry is to receive government loans to increase output, be relieved of excessively burdensome taxes,

1. Chen Po-ta, op. cit.

2. Directive of the Central Plains Liberated Areas, as quoted in FBIB, Daily Report, September 14, 1948, p. CCC-3, RESTRICTED.

3. "New Industrial and Commercial Policy of the Shansi-Hopeh-Shantung-Honan Central Bureau," Liao-nan Jih-pao, No. 298, May 8, 1948, as quoted in DX-OO-W-774, September 24, 1948, RESTRICTED.

and obtain the cooperation of labor unions in promoting economic development. Within the limitations set by continued economic warfare, trade must be free within the liberated area and "all marketing controls now imposed by the villages must be abolished."

2. Economic Practice in the Administration of Cities

a. Early postwar practice. The Communist occupation of Kalgan (August 1945-October 1946) was characterized by the dominance of government over the industrial and commercial sectors of the city. In taking over the industrial properties formerly operated by the Japanese, the Communists assumed control of most of Kalgan's modern industry. Although the investment of private capital in some of these plants was encouraged, the fundamental economic decisions regarding the composition and distribution of output were made by Communist authorities. Private industrial firms, for the most part small in size, were hampered by excessively high standards imposed by the government with respect to working conditions and wages, and were largely dependent on government sources for raw material supplies; private trade within the city suffered from the competition of government-controlled cooperatives. External trade was subject to blockade measures adopted both by the Communists and the Kuomintang. Such trade as did take place was carried out directly by the Communist trade corporation, by private merchants acting for the Communist authorities or subject to their control

measures, or by party members located in outside areas. Private merchants from Pei-p'ing and other Kuomintang areas were encouraged to bring in imported supplies, but the return movement of commodities appears to have been closely supervised.

During the Communist occupation of Che Foo (August 1945-September 1947), trade and industry appear to have been generally depressed more because fuel, power, and raw materials were short than as a direct consequence of Communist economic controls. There are some indications, however, in the extremely fragmentary information available, that a haphazard tax policy and confiscatory practices toward the wealthy resulted in a flight of capital and a reduction in economic activity. In April 1946, Communist authorities announced that they would welcome foreign business and expressed an interest in making Chefoo a center for the exchange of foreign imports of machinery, fertilizer, and other products for Communist North China's export commodities.¹ The only significant trade that did take place, however, appears to have been confined to traffic between Chefoo and Soviet-controlled Dairen.

Communist administration of Harbin, dating from April 1946, has been characterized by particularly extensive economic controls and by the favored position granted to the USSR in the area. Information relating to conditions in 1947 indicated that free

1. DX-YV1573, May 9, 1946, CONFIDENTIAL.

trading in staple foods was prohibited (basic food supplies were distributed through local rationing stations), large retailing establishments were closing because of excessively high taxes, and the composition and distribution of industrial output were subject to government control either through direct operation of plants or through the state's power in allocating raw materials to privately owned companies.¹ The continued existence of a black market for many commodities, however, indicated that such controls were still not complete.

Such foreign-owned firms as the British-American Tobacco Company were reported to be operating, but their output was subject to government distribution. The Soviet-owned Tschurin Company, on the other hand, appeared to have greater autonomy in its activities. In addition to operating cement, alcohol, and food processing plants, this company acted as an agent of the USSR in its trade with the Chinese Communists. Reliable data on these transactions are not available, but they are reported to have been on a considerable scale and to have involved the exchange of Manchurian grains, fats, and furs for various producers' and consumers' goods. One source indicated that grains and fats were shipped to the USSR at a time when Harbin's supply of such commodities was short.²

1. D-21, Ch'ang-ch'un, October 14, 1947, RESTRICTED.

2. T-356, Mukden, September 1, 1948, SECRET.

Recent announcements by Harbin officials point to a continuance of the trend toward increasing state controls. Private investment supposedly was to be encouraged following the inauguration of the policy "protecting industry and commerce" in January 1948, but a large part of the market for private capital funds apparently consisted of joint public-private companies such as the Harbin Business Corporation, reported to have begun operations in July, 1948 for the purpose of organizing and assisting various types of industries.¹ Private industry presumably is expanding, but under the "guidance of state industries"; a government corporation formed in the latter part of 1947 is charged with the responsibility of "supporting industrial production, trading in goods, meeting civilian needs, and adjusting money markets and commodity prices" so as to perform "a significant function in controlling commerce, markets, and prices;" and certain commercial establishments, notably foreign trade merchants, "can expect no further development."²

b. Recent developments. Occupation policy during 1948, as additional large urban centers came under the control of the Chinese Communist Party, reflected the party's emphasis on an urban policy appropriate to its improved political position. The chief objective was to minimize economic disorders attendant on a change in regime

1. Kwantung Jih-pao, No. 347, 1948, as quoted in DX-00-W802, October 1948, RESTRICTED.

2. FBIB, Daily Report, September 27, 1948, pp. PPP-4-11, in which the vice mayor of Harbin reviews economic developments for the past year, RESTRICTED.

in order to restore urban activity and ease the burden of administration. Toward this end Communist Party administrative organs rapidly brought in food supplies adequate to meet requirements and stabilize market conditions, and initial directives stressed the "new policy of protecting industry and commerce" and the various provisions tending to reassure private urban interests.

Available information relating to these newly captured cities indicates that the Communists have been successful in realizing their initial objectives. Business activity appears to have been resumed at Tsinan, and several mills have been reopened there.¹ At Mukden, local government officials and technicians were quickly won over to the Communists, utilities were returned to operation, and economic relationships with the countryside were restored.²

There are some indications that one aspect of the initial policy of moderate social change in the cities is a cooperative attitude toward foreign enterprise and trade. The manager of the British-American Tobacco Company plant in Mukden was told that the Communist government would not interfere with domestic and foreign trade conducted by foreigners³ and that it was interested in the resumption of production at the plant under its present ownership and control.⁴ Similarly, Communist officials in Mukden have expressed their interest in foreign trade with the British at Hong Kong⁵ and with American businessmen "on the basis of equality."⁶

1. LX-CC-R-9071, December 14, 1948, CONFIDENTIAL.
2. T-586, Mukden, November 17, 1948, CONFIDENTIAL.
3. T-536, Mukden, November 9, 1948, CONFIDENTIAL.
4. T-576, Mukden, November 15, 1948, CONFIDENTIAL.
5. T-538, Mukden, November 9, 1948, CONFIDENTIAL.
6. T-536, Mukden, November 9, 1948, CONFIDENTIAL.

II. THE ECONOMIC DETERMINANTS OF FUTURE COMMERCIAL POLICY

A. General Considerations

Analysis of the past economic policy of the Chinese Communist Party indicates the extent to which economic programs have varied with changes in the party's political status and economic requirements. These broad shifts in economic tactics, moreover, apparently were permissible within an ideological framework set by the unchanging ultimate objective of a Communist state. The fact that party leaders have been realists as well as Marxists suggests that future attitudes of the party toward such problems as external and internal trade policy and the role of private enterprise, both domestic and foreign, in the Chinese economy will be importantly influenced by underlying economic factors.

Examination of these factors as an index to future commercial policy must depend on assumptions regarding the nature and extent of Communist control in China. For this purpose, it is assumed that the Chinese Communist Party will achieve effective control over a unified China during 1949, either directly or through its dominance over a coalition government, and with this control the responsibility for China's postwar rehabilitation, arbitrarily assumed to extend over the next five years. Under these assumptions, the government's balance-of-payments problems following the end of the Civil War may be tentatively assessed and the implications of these problems for the commercial policy of the Chinese Communists noted.

B. Political Unification and the Balance of Payments

1. The Postwar Disequilibrium in China's Balance of Payments.

China's foreign trade deficit has reached unmanageable proportions since the end of the Japanese war. Commercial transactions showed an excess of imports over exports of more than US \$400 million in 1946 and US \$250 million in 1947. If account is taken of government purchases and UNRRA shipments, the commodity deficit approximated US \$800 million in 1946 and US \$650 million in 1947. Thus, despite substantial foreign grants during these two years, the government's reserves of gold and US dollars were reduced from US \$900 million at the end of 1945 to less than US \$250 million at the end of 1947. Similarly in 1948, the total value of commercial and government imports, together with the commodities shipped to China under the CRM (Chinese Relief Mission) and ECA programs, exclusive of military aid, is estimated to have exceeded the value of China's exports by over US \$300 million.

It is to be noted, moreover, that these deficits occurred without substantial imports of equipment deemed essential for China's postwar rehabilitation. Industrial and transport equipment constituted only 25 percent of total UNRRA supplies; capital goods accounted for approximately 15 percent of China's total commercial imports in 1946 and 1947. With some few exceptions, notably shipping capacity, modern transport and industrial facilities have deteriorated in the postwar period owing to lack of adequate replacement and rehabilitation materials as well as to the general disorganization in industrial conditions.

The disequilibrium in China's postwar international accounts in large measure has reflected the pervasive influence of the civil war on the Chinese economy. Direct military needs, together with the immobility of domestic resources and output resulting from disrupted communications and divided political control, expanded import requirements. At the same time, chaotic financial conditions and the physical barriers to the renewal of trade tended to dry up the government's sources of foreign exchange. Exports were restricted to less than 40 percent of the prewar volume and remittances from overseas Chinese were increasingly transmitted through unofficial channels. As the government's exchange reserves were drawn down, continued supply of essential import commodities became increasingly dependent on foreign grants and loans.

2. Prospective Improvements following Internal Stability in China.

With the cessation of hostilities and control consolidated under a Communist government, China's balance-of-payments position may be expected to change drastically. Restoration of internal trade and economic consolidation of areas formerly under separate political control would tend to reduce requirements for foreign food and raw material supplies and to lessen the physical barriers to increased exports. The resulting change in China's net position on current international account would depend on such interrelated factors as:

(1) the rate at which a Communist government would attempt to import

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reconstruction equipment; (2) the effectiveness of its trade controls; and (3) the extent to which foreign trade was conducted on the most advantageous economic grounds. As an index of the government's potentialities in this respect, prospective changes over a five-year period in imports (exclusive of rehabilitation items), exports, and certain invisible items will first be examined under certain favorable assumptions -- e.g., that governmental controls over the economy will be greatly improved, that trade will be conducted on grounds abstracted from political considerations, and that a substantial degree of reconstruction will take place over the period. The magnitude of import requirements for reconstruction and the ability of the government to finance such requirements will then be discussed in subsequent sections.

a. Merchandise transactions. Reductions in import requirements from the 1947-48 level should be substantial. The need for material imported under special government account since the end of the Japanese war, estimated at US \$100 million a year and including munitions, bank notes, and military petroleum supplies, should be largely eliminated; it should be possible to reduce raw cotton and food imports; and a government bent on conserving foreign exchange for rehabilitation and development purposes could be expected to cut heavily all imports of non-essential consumers' goods and raw

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materials for non-essential industries. Increases in imports, on the other hand, apart from reconstruction items, would be required in the case of maintenance equipment and certain industrial raw materials necessary for normal replacement and for expanded industrial operations.

The extent of potential import reductions is reflected most clearly in the cases of raw cotton, food, and petroleum -- products that constituted perhaps half (in value terms) of China's total imports since 1945. As internal trade is restored and agricultural production becomes guided by exchange-relationships rather than by considerations of self-sufficiency, domestic raw cotton and cereals will be increasingly substituted for imported supplies. Over a five-year period, the value of China's annual imports of these commodities should be reduced by at least US \$200 million from 1947-49 levels. Possible reductions in petroleum imports are significant but not as substantial. On the assumption that a Communist government would inherit an oil-burning merchant fleet and that impaired railroad capacity would require a considerable operation of motor and air transport equipment, petroleum requirements would still be considerable. A reduction of US \$25-50 million, however, could be expected as a result of reduced military needs and the reconversion to coal of oil-burning industrial and power plant equipment.

Export potentialities following the end of the civil war similarly indicate a marked improvement in China's prospective balance-of-payments position. It is estimated that total exports from China proper, Manchuria, and Formosa could reach approximately US \$500 million in the first year or two following internal stability and expand to an annual rate of nearly US \$600 million within a five-year period, if China's transport system is virtually reconstructed. This is to be contrasted with the situation in 1947-48, when exports were limited to the US \$200 million in commodities moving through recorded channels in addition to undetermined quantities smuggled out of China proper or exported by the Communists from Manchuria.

The projected expansion in China's export potential arises largely from the inclusion of Manchurian exports of soybeans, grains, and minerals, together with the recovery of many of China proper's traditional exports following an improvement in internal trade. The relatively rapid rate of increase estimated for the period immediately following the end of the civil war is based on the supposition that exports of high value in relation to their bulk can be increased with improved marketing conditions even in the absence of complete transport reconstruction. It must be emphasized, however, that these estimates assume that increased exports will be a primarily economic objective of a Communist government and that

there will be no political restrictions with regard to markets.

b. Remittances and debt servicing. Of the major invisible items in China's foreign balance on current account, remittances from overseas Chinese and charges for servicing foreign debt are most likely to be immediately affected by internal stability and the accession of a Communist government. Emigrant remittances during the postwar period increasingly were diverted to extra-legal channels as a result of the persistently overvalued exchange rate. Official receipts are estimated to have dropped a low of US \$15 million. Despite the impaired economic position of Chinese in the South Seas area immediately after the end of the Japanese war, it seems probable that actual remittances in postwar dollars approximated the prewar level. On this basis it may be reasoned that, if the Communists can achieve economic stability in China, remittances will largely revert to official channels, giving the government access to approximately US \$100 million in foreign exchange.

Foreign exchange requirements for servicing the external debt, on the other hand, will depend largely on the manner in which the Communists gain power and the prospects for receiving new foreign loans. At the present time China has outstanding approximately US \$1 billion in external obligations. Of this total, US \$250 million represent prewar debts on which payments were suspended in 1939, about US \$600

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million are wartime obligations (including the \$500 million US "loan" of 1942), and US \$175 million constitute credits granted since the end of the Japanese war by the US and Canada. The National Government's servicing arrangements on these obligations cannot be determined with accuracy, but it is estimated that payments in 1948 were approximately US \$50 million, including over US \$10 million in commodity payments to the USSR. If the Communists gain power through a coalition government, certain foreign obligations may continue to be serviced as a means of gaining international recognition. As a general principle, however, it may be presumed that debt servicing will be continued only as long as new foreign credits are being made available or are an immediate prospect.

3. Reconstruction Requirements. These prospective improvements in China's balance of payments position may now be related to import requirements for rehabilitation purposes. In China proper and Formosa railroad rehabilitation would be the most important and at the same time the most costly element in a reconstruction program. On the basis of a survey made by an American engineering firm in 1946 and adjusted for subsequent developments, railroad rehabilitation would require approximately US \$400 million, including US \$300 million in imported materials, equipment, and services. This estimate presumably could be scaled down to allow for somewhat lower standards

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than those assumed in the survey. An additional US \$100-\$150 million may be tentatively allocated for imports of materials and equipment for all other industry, including textile, power, and mining equipment.

Reconstruction requirements in Manchuria can be assessed only on the most tenuous basis. The modern industrial plant in that area was built up to a value of over US \$5 billion during the Japanese occupation. Soviet removals, civil war damage, and deterioration as a result of undermaintenance have probably reduced its value to less than US \$2 billion. In addition, the economy on which this plant was based is now completely disorganized. The problem of reconstruction, therefore, cannot be tied simply to the peak war-period plant but must depend on government decisions regarding the rate and pattern of China's future economic development. On a minimum basis, however, which may be defined as calling for the reconstruction of Manchuria's railroad system and perhaps half of its war-period industrial and power capacity, import requirements may be assessed at US \$300-500 million.

4. The Foreign Balance on Current Account. The extent to which a Communist government would be subject to the pressure of a stringent foreign exchange position can now be tentatively assessed. On the basis of the foregoing assumption and analysis, the government would have the potentialities, over a five-year period, of

devoting an average of perhaps US \$100 million per year for the importation of reconstruction equipment. This would be sufficient to finance at least half of China's most pressing rehabilitation requirements.

The magnitude of such an achievement, and by the same token the uncertainties involved, must be made more explicit. The analysis presumes in the first instance that the government so organizes the economy as to be able to mobilize a substantial volume of domestic resources for capital formation. Second, stating the exchange receipts potentially available for reconstruction as an average amount over the period obscures some of the additional problems involved. The experience of the National Government suggests that the pressure of foreign exchange requirements will be especially great at the beginning of the period following the end of the civil war. Although it is clear that improved commodity distribution in China will permit the substitution of domestic for imported supplies at an increasing rate, time is nevertheless required for such improvement to take place. Similarly, expanded export potentialities and possible reductions in the import of certain raw materials and foodstuffs are directly related to the rate at which reconstruction takes place. If China's foreign accounts are to become manageable in the first place and then to show

progressive improvement over the period, prerequisites are rapid achievement of economic stability, effective controls over foreign trade, and a greatly improved fiscal structure.

C. Attitudes Toward Foreign Trade

1. The Mechanics of Trade. The balance-of-payments difficulties that will immediately confront a Communist government in China, together with the necessity of solving these difficulties if progress is to be made in reconstructing and developing the Chinese economy, point to rapid state controls over foreign trade. If imports are to be restricted to levels projected above, more effective controls must be imposed than those exercised through the extensive regulations of the National Government. Similarly, expanded exports would entail not only a reduction in the volume of smuggling but also the stimulation of export industries and the channeling of their output to export outlets.

The past operations of the Chinese Communist Party and the policies pursued by newly formed Communist governments in Eastern Europe tend to reinforce this conclusion. Chinese Communist tactics in economic warfare, both with the Japanese and with the Kuomintang, have reflected an awareness of the importance of foreign trade controls and the ability to apply such controls with relative effectiveness. Similarly, in occupying cities, the establishment

of government trading corporations has been among the first actions effected by the Communist authorities. There apparently has been no contradiction between these actions and the Chinese Communist Party's avowed policy of maintaining unrestricted internal commerce.

In Eastern Europe, foreign trade has passed almost entirely out of private hands since the end of the war. Government monopolies have been established to provide shipping, insurance, and freight forwarding services as well as to transact international sales and purchases. Trade carried on outside government channels is limited in scope, subject to strict import and export controls, and apparently tolerated only until state agencies are prepared to take over.

The operations of the National Government since the end of the Japanese war provide the Communists with a convenient precedent and base for achieving the same purpose. By taking over the properties of the National Resources Commission, the Chinese Textile Industries, the China Merchants Steam Navigation Company, and other corporations dominated by the National Government and provincial governments, Communist authorities would obtain direct control over a major portion of the industrial sector in China proper and Formosa. Similarly, continuance of the functions of such organizations as the Central Trust and the China Vegetable Oil Company would directly involve the government in the collection

and sale of export commodities and in the purchase of imported supplies. The combined operations of these corporations and agencies would constitute an impressive starting point for the development of integrated state trading operations.

This is not to imply, however, the immediate exclusion of foreign trading enterprises in China. To the extent that such firms have unique experience in the conduct of foreign trade, aid in sorting and grading commodities for foreign markets, and can supply needed credit facilities for the sale of such commodities, they would be of significant economic value to the initial operations of a Communist government. China's huge requirements for reconstruction and development, moreover, indicate that foreign enterprises may have a somewhat greater life expectancy in China than has been the case in other Communist areas. What can be expected at an early date in a Communist administration of China is an attempt by Communist authorities to use monopoly powers for the exaction of improved terms of trade either in bargaining with foreign firms in China or in direct operations abroad. The advantages that could be gained from such operations, however, would be limited by the generally poor competitive position of Chinese export commodities in world markets.

2. Markets and Sources of Supply. The trade projections outlined above assume disregard of political considerations in the determina-

tion of China's foreign markets and sources of supply. These considerations may now be examined in the context of their effect on a Communist government's balance of payments and on its commercial policy.

a. Trade with the US. Since the end of the Japanese war the US has been the largest single foreign participant in China's external trade. After the end of the civil war China's import requirements and the nature of its export commodities will constitute strong incentives for continued trade. Raw cotton and petroleum, for which the US has been the principal source, would still be needed in substantial although reduced volume. And if China is to receive the variety of industrial raw materials and capital equipment necessary for the operation of its industrial sector and the reconstruction of its economy, access to American supplies will be necessary.

Moreover, the foregoing estimates of China's export potentialities implicitly included the US as a market for perhaps 20 to 25 percent of China's total exports. In the case of many of the export commodities involved, including tung oil, bristles, silk, tea, and handicrafts, the US would constitute the major element in world demand. Absence of the American market, therefore, would of necessity depress certain export industries and force a

sharp reduction in their prices and a decline in the level of China's foreign exchange receipts.

b. Trade with Japan. Although leaders of the Chinese Communist Party have at times strongly opposed the revival of Japan's industry, there is some question as to whether their statements can be taken as an accurate index of the party's position. In any case, the extent to which Chinese Communist commercial policy is directed against the industrial reconstruction of Japan will be tempered by the underlying economic advantages arising out of trade with Japan. In assessing such advantages, it is not necessary to base trade projections on the levels of the prewar period, when Japan occupied a dominant position in Manchuria and the Far East in general. Even at the rate of recovery projected in recent SCAP programs, Japan could absorb 50 to 75 percent of China's soybean surplus, most of its potential exports of coal, iron ore, and salt, and less substantial quantities of bran, raw cotton, and hides and skins. In return China could receive significant supplies of its high-priority import requirements, including railroad and electrical equipment, various other types of machinery and metal manufactures, paper, and chemicals.

c. Trade with the USSR. On the basis of its requirements, the USSR could be a major market for China's exports. It is conceivable that all of Manchuria's soybean surplus could be absorbed in meeting the shortage of edible oils in the USSR, and

food deficiencies in the Soviet Far East point to a ready market for Manchuria's potential grain exports. Of the exports of China proper, the Soviet Union would be interested primarily in non-ferrous minerals, tung oil, and certain animal products. It is estimated that the Soviet market could readily absorb 30 to 40 percent of China's total exports, or, in value terms, approximately US \$150-200 million per year computed at world market prices.

The problems involved in exports of this magnitude relate primarily to the Soviet Union's means of payment. If trade were conducted on a barter basis, the commodities China would require in exchange, especially capital goods, petroleum products, and raw cotton, would generally be in short supply in the Soviet Union or would involve excessive transport costs. If the USSR actually sent to China commodities needed by the Chinese at prices for which they could be obtained elsewhere, it would entail some sacrifice to the Soviet domestic economy. The projected level of trade in comparison with the level of income of the Soviet Union indicates, however, that such sacrifice would be small in relative terms and might in any event be fully justified on political grounds.

If, on the other hand, the USSR pursued a policy of economic exploitation in China, similar to those it has adopted in Eastern Europe, its economic weapons in Manchuria could be uniquely adaptable to its purposes. Soviet control over the port of Dairen, which

handled 70 percent of Manchuria's prewar foreign trade, could influence the direction and terms of China's trade. Second and perhaps more important in this context, the Soviet Union has extensive claims over Manchuria's railroads and industry as a result of its agreement with the National Government in 1945. Recognition of these claims by the Chinese Communist Party would provide the USSR with controls over these properties and a share in the profits from their operations.

The cost to the Chinese Communists of Soviet economic exploitation in Manchuria can be graphically illustrated by the soybean trade. During the postwar period most of Manchuria's soybean surplus has reportedly been shipped to the USSR on a barter basis. Although available evidence on this point is fragmentary, it appears that the price at which soybeans were traded was considerably less than half that paid by SCAP for soybean imports into Japan. In this case, however, the absence of alternative export outlets left the Chinese Communists with little choice. In the period immediately after the end of the civil war, China's soybean surplus would be substantially less than the potential requirements of the USSR, Japan, and Western Europe, with the result that large-scale shipments to the USSR could be made only at the expense of exports to these other areas. If such shipments were made at prices below the world market price and were paid for in part by the profits accruing out of Soviet "investments" in Manchuria, China's ability to finance its essential import requirements would be drastically impaired.

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This conflict between political considerations and economic objectives would be evident in a large part of the Chinese Communist Party's commercial policy. Even if trade were conducted on purely economic grounds, the limitations of China's potential foreign exchange receipts in terms of its essential import requirements would at best leave a Communist government in China with an uncertain and narrow margin for financing reconstruction needs. In these circumstances, the attempt to force trade into Soviet channels either because of an anti-Western political orientation or because of direct Soviet pressure could be made only at the expense of reconstruction and development.

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